Supreme Court, U. S.
FILED
OCT 11 1979
MICHAEL RODAK, JR., CLERK

No. 79-325

IN THE

# Supreme Court of the United States

October Term, 1979

THE GRAND BAHAMA DEVELOPMENT COMPANY, LIMITED, a Bahamian corporation, et. al., *Petitioners,*

*vs.*

CLARENCE A. ANDERSON, et al., *Respondents.*

On Petition for a Writ of Certiorari to the Appellate Court of Illinois, First District, Fifth Division

## PETITIONERS' REPLY MEMORANDUM

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## PETITIONERS' REPLY MEMORANDUM

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Petitioners submit this memorandum in reply to new matters raised by respondents in their brief in opposition to the Petition for Certiorari.

### Argument

1. Respondents argue that the federal and Illinois securities laws should be given an expansive reading and applied to the contracts for the purchase of residential lots in real estate developments involved here (Br. in Opp. 10-12). They assert that any investment in land in a real estate development which includes plans for customary amenities such as roads, recreational facilities and parks is a security in the form of an investment contract.

The expansive application of the securities laws urged by respondents and adopted by the Appellate Court of Illinois in this case would work a severe hardship on sellers of land while adding little to the rights and remedies of buyers. Sellers who have not registered sales of land with securities commissions in reliance on past administrative pronouncements and judicial decisions would suddenly be faced with massive liabilities for their failure to comply with the securities laws. They would also face a heavy burden in complying with those laws in the future and would become less willing to offer purchasers any improvements or amenities along with subdivision tracts. On the other hand, land buyers already have adequate and effective remedies against sellers under the federal Interstate Land Sales Full Disclosure Act and state land sales acts.

Obviously many persons who purchase real estate, including many of those who purchased land from petitioners, do so in whole or in part for investment purposes. Only particular investments, however, are securities as that term is used in connection with the federal and state securities laws. The key element that makes an investment a security is the participation of the investor in a common enterprise where profits are to be derived solely from the efforts of others. That essential element is simply not present in this case.

Congress and the state legislatures never intended the securities laws to cover the type of land sales involved here. The Appellate Court of Illinois should not be permitted to expand the securities laws to achieve such a result.

2. Respondents err in contending that the Appellate Court's judgment is not ripe for review because it is not



a final decision on the merits but only a reversal of the trial court's order granting petitioners' motion to dismiss (Br. in Opp. 1, 3). However, this Court has frequently reviewed such judgments. In actions involving securities laws in particular, petitions for certiorari by defendants have been granted in a number of cases in which courts of appeals have sustained causes of action which had been dismissed by trial courts. See *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975); *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837 (1975); *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976); *Teamsters v. Daniel,* — U.S. —, 58 L.Ed.2d 808 (1979).

Since resolution of the issue presented by the Petition for Certiorari is "fundamental to the further conduct of the case," review of the Appellate Court's decision at this time is manifestly appropriate. See *United States v. General Motors Corp.,* 323 U.S. 373, 377 (1945); *Land v. Dollar,* 330 U.S. 731, 734 n.2 (1947); *Larson v. Domestic & Foreign Commerce Corp.,* 337 U.S. 682, 685 n.3 (1949). Reversal of the Appellate Court's decision would also eliminate the need for a lengthy and complex trial on respondents' claims under the federal and state securities acts.

3. Respondents correctly state that on a motion to dismiss all of the well pleaded facts in a complaint must be taken as true (Br. in Opp. 5-6). But it is also well settled that such a motion does not admit conclusions of law or inferences and conclusions as to matters of fact contained in the complaint. See *Newport News Shipbuilding & Dry Dock Co. v. Schauffler,* 303 U.S. 54, 57 (1938); *Missouri Pac. R. Co. v. Norwood,* 283 U.S. 249, 254 (1931); *Pierce Oil Corp. v. City of Hope,* 248

U.S. 498, 500 (1919); *Unger v. Checker Taxi Company,* 30 Ill. App. 2d 238, 174 N.E.2d 219, 221 (1961); *Kurek v. Kavanagh, et al.,* 50 Ill. App. 3d 1033, 365 N.E.2d 1191, 1194 (1977).

In order to state a cause of action, respondents must directly allege facts which, if true, would establish that the land contracts were investment contracts under the definition in *SEC v. W. J. Howey Co.,* 328 U.S. 293, 298-299 (1946):

> "[A]n investment contract for purposes of the Securities Act means a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. . . ."

Paragraphs 1 through 18 of the complaint in this case contain allegations regarding the identity and description of the parties to the suit, petitioners' plans for real estate developments on Grand Bahama Island, and petitioners' efforts to promote the sale of lots in those real estate developments (Br. in Opp. 6-7). Paragraphs 19 and 20 of the complaint contain conclusory statements that the facts alleged in paragraphs 1 through 18 establish that the lots purchased could increase in value solely through the efforts of petitioners and that respondents could do nothing themselves to increase the value of their investments (Br. in Opp. 7-8).

Respondents have not supported these assertions by direct allegations of fact showing that they were prevented from developing their lots and thereby enhancing the value of their investments, because they could in fact have made such improvements. Yet the Appellate Court expressly and improperly based its decision on these conclusory assertions.



Furthermore, the contracts entered into between petitioners and respondents which were attached as exhibits to respondents' complaint contained no promises, representations, or agreements that petitioners would develop, control, or manage the land purchased for the benefit of respondents. These documents refute the assertions in respondents' complaint that petitioners and respondents were engaged in a common enterprise. Where allegations in a complaint are in conflict with facts disclosed in exhibits, the exhibits must control. See *Wilbur Waggoner Equipment Rental Co. v. Johnson,* 33 Ill. App. 3d 358, 342 N.E.2d 266, 269 (1975); *Sangamon County Fair Assn. v. Stanard,* 9 Ill. 2d 267, 137 N.E.2d 487, 493 (1956); *Wilbur v. United States,* 288 U.S. 97, 101 (1933).

The direct allegations of fact in respondents' complaint, even when taken as true, do not establish that petitioners and respondents were embarked on a common enterprise, nor do they establish that respondents had to rely solely on the efforts of petitioners to increase the value of their investments.

4. Respondents argue that the Appellate Court discussed all the applicable precedent controlling the definition of a security (Br. in Opp. 10). Yet the Appellate Court relied heavily on *McCown v. Heidler,* 527 F.2d 204 (10th Cir. 1975), a case subsequently limited by *Woodward v. Terracor,* 574 F.2d 1023 (10th Cir. 1978), which was not considered by the Appellate Court. Moreover, the Appellate Court did not consider this Court's decision in *United Housing Foundation, Inc. v. Forman, supra,* in which the *Howey* test was applied to interests in real estate, nor did it consider *Teamsters v. Daniel, supra,* which was decided by this Court subsequent to the Appellate Court's decision.

Respondents erroneously assert that *Lowery v. Ford Hill Investment Co.*, 556 P.2d 1201 (Colo. 1976), stands for the proposition that simple land contracts are securities, whether the purchase is made for investment purposes or for personal use (Br. in Opp. 11). What *Lowery* actually held was that contracts for the sale of condominium units constituted "investment contracts" within the meaning of the Colorado Securities Act where the sales were accompanied by mandatory agreements imposed by the seller under which purchasers of the units were required to pay fees to the seller and to rent their units through a common agent employed by the seller who distributed shares of the rental income received to the owners of the units.

The Colorado Supreme Court stated that "[w]hile this court is not bound by federal law in the interpretation of the Colorado Securities Act, we find that insofar as the provisions and purposes of our statute parallel those of the federal enactments, such federal authorities are highly persuasive." It went on to hold that the venture in question was a common enterprise within the meaning of the *Howey* formula. *Lowery, supra,* at 1204-1205.

One of the factors relied on by the court in *Lowery* was the pronouncement of the Securities and Exchange Commission in "Offers and Sales of Condominiums in a Real Estate Development," SEC Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973), which set forth the Commission's opinion that the mere offer and sale of condominium property or land in a real estate development does *not* constitute a securities transaction under federal law. Condominium offerings only involve securities, the Commission stated, when coupled with rental pool arrangements run by exclusive rental agents.



Respondents also refer to *In Re McCormick's Estate,* 284 Ill. App. 543, 1 N.E.2d 769 (1936) (Br. in Opp. 12). That case involved contracts for the sale of lots in a subdivision which provided that the developer would install certain public improvements such as sewers, pavements, water and gas mains, and landscaping in the subdivision. The Illniois court held that a sale of securities was *not* involved, noting that those who purchased the lots "had no interest whatever in any of the other lots in the subdivision or in any property belonging to the vendors or the proceeds thereof," and reasoning that "if the Legislature had desired to include ordinary sales of real estate in the Illinois Securities Law, it would have been a simple matter for them to have done so." *In Re McCormick's Estate, supra,* at 772.

*Lowery* and *In Re McCormick's Estate, supra,* both support petitioners' argument that land contracts of the type involved here are not securities in the form of investment contracts.

## Conclusion

The question raised by this case is whether contracts for the purchase of residential lots in a real estate development constitute securities in the form of investment contracts within the meaning of federal and state securities acts when the development includes plans for public facilities and other amenities which serve the lots involved.

The Appellate Court of Illinois has held that such land contracts constitute securities. Its decision is at variance with applicable decisions of this Court in the securities area and is in direct conflict with decisions of federal courts of appeals and federal district courts which have considered this question.

The issue involved here is of major importance to purchasers and sellers of real estate and directly affects the administration of federal and state securities laws. It deserves resolution by this Court.

*Respectfully submitted,*

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